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**In the Supreme Court of the United States**

**No. 565**

**October Term, 1943**

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**WISCONSIN GAS AND ELECTRIC COMPANY,**

*Petitioner,*

**vs.**

**THE UNITED STATES OF AMERICA.**

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**On Writ of Certiorari to the  
United States Circuit Court of Appeals for the Seventh Circuit.**

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**BRIEF FOR THE PETITIONER**

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**OPINIONS.**

One opinion was delivered by the District Court. It was written by District Judge F. Ryan Duffy and filed September 25, 1942. It appears on page 6 of the Record and is reported in 46 Fed. Supp. 929. The opinion of the

Circuit Court of Appeals for the Seventh Circuit, (Circuit Judges J. Earl Major and Sherman Minton and District Judge Walter C. Lindley, Judge Minton writing) was filed November 8, 1943, and appears at page 20 of the Record. It is reported in 138 Fed. (2d) 597, advance sheets.

### JURISDICTION.

A petition for writ of certiorari herein was granted by this Court on January 31, 1944 and the case was transferred to the summary docket.

The judgment of the Circuit Court of Appeals for the Seventh Circuit was entered November 8, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code.

Cases wherein jurisdiction was sustained for the purpose of review by certiorari in Internal Revenue matters are:

*International Railway Co. vs. Davidson*, 257 U. S. 506;

*Smietanka vs. First Trust and Savings Bank*, 257 U. S. 602, at p. 604.

### QUESTIONS PRESENTED.

1. Whether petitioner, a Wisconsin corporation engaged solely in the operation of public utilities within the State of Wisconsin and paying to that State, out of earnings from such public utility operations, pursuant to liability for payment imposed *solely* upon it under the Wisconsin privilege dividend tax law (Laws of Wisconsin (1935), c. 505, Sec. 3, as amended by Laws of Wisconsin (1935), c. 552, Sec. 1), taxes measured by the amount of dividends declared and paid to stockholders, may, for Federal income tax liability, and under Section 23 (c) of the

Revenue Act of 1934, claim the amount of such charge as a deduction from gross income, notwithstanding the contention, in opposition to deductibility, that it did not bear the ultimate economic burden of the tax?

2. Whether the amount of the payment from the petitioner to the State of Wisconsin for Wisconsin privilege dividend taxes should be allowed to the petitioner as a deduction under Sec. 23 (d) of the Revenue Act of 1934 as "taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder", if, notwithstanding the decisions of this Court and the Wisconsin Supreme Court holding the privilege dividend tax to be incident to corporate privileges and protection extended by the state, it is held that the tax is imposed upon the shareholder?

#### SUMMARY STATEMENT.

This case was tried upon a stipulation for agreed statement of facts and the findings of fact filed by the District Court of the United States for the Eastern District of Wisconsin summarize the relevant matters. (R. 9) The petitioner is a Wisconsin corporation engaged in the operation of public utilities wholly within the State of Wisconsin wherein it has its principal office. Out of the earnings attributable to such business, the petitioner made a declaration and payment of dividends in the year 1935, and in that year made payment to the State of Wisconsin pursuant to the privilege dividend tax law of that State, of the sum of \$3,750.00, measured by the amount of the dividends declared and paid. The petitioner, by return based on the accrual method, claimed the amount of such payment as a deduction for that year for Federal income tax purposes under Section 23 (c) or (d) of the Revenue Act of 1934.

The Internal Revenue Agent disallowed such deduction and petitioner paid its tax liability in full without benefit of any deduction for the amount paid to the State of Wisconsin as privilege dividend tax. The petitioner, on May 9, 1939, timely filed with the Collector of Internal Revenue for the Eastern District of Wisconsin a claim for refund, inclusive of the tax resulting from the disallowed amount paid to the State of Wisconsin as privilege dividend tax. On October 31, 1940, the Commissioner of Internal Revenue rejected and disallowed the claim for refund and the petitioner, on February 19, 1941, filed suit in the District Court of the United States for the Eastern District of Wisconsin for recovery of the amount of tax specified in its claim for refund attributable to the amount paid to the State of Wisconsin as privilege dividend tax.

The District Court entered judgment in favor of the petitioner on October 6, 1942. Judgment of reversal was entered in the Circuit Court of Appeals for the Seventh Circuit on November 8, 1943, and it is such judgment that petitioner seeks to review.

As indicated by the opinion of the trial court, the question for decision is the petitioner's right to the deduction of privilege dividend taxes paid to the State of Wisconsin during the taxable year (R. 7). The Government asserted before the trial court and in its brief in the Circuit Court of Appeals that the tax was not paid by the corporation but by the shareholders and, accordingly, the amount paid was not deductible by the corporation under Section 23 of the Revenue Act of 1934. The Government's contention was rejected by the trial court but adopted by the Circuit Court of Appeals for the Seventh Circuit (R. 22).



## **SPECIFICATION OF ERRORS TO BE URGED.**

The Court below erred:

1. In holding that the petitioner was foreclosed from deducting from gross income, in the computation of Federal Income tax liability, the amount paid as Wisconsin Privilege Dividend Tax because the Wisconsin Supreme Court had determined, for purposes of the State Income Tax Statute, that the economic burden of the tax was imposed upon the shareholders of petitioner.

2. In failing to recognize the petitioner's claim for deductibility of the tax under Section 23 (d) of the Revenue Act of 1934 if the tax was held to be one imposed upon shareholders.

## **STATUTES INVOLVED.**

The pertinent provisions of the Revenue Act of 1934 (Sec. 23), together with the provisions of the Wisconsin Privilege Dividend Tax (Laws of Wisconsin (1935), c. 505 Sec. 3, as amended by Laws of Wisconsin (1935), c. 552, Sec. 1) are printed in the Appendix, *infra* pp. 41, 39.

## **SUMMARY OF ARGUMENT.**

### **I.**

The Wisconsin Privilege Dividend Tax is payable by the corporation and is collectible from it only. The usual incidents of tax liability arising from it devolve upon the corporation. The ultimate economic burden of the tax is not important under Section 23 of the Revenue Act of 1934.

Both the Statute and the state administrative practice thereunder treat the corporation as the taxpayer. (p. 9)



The Wisconsin Court has confirmed the theory that the validity of the tax rests upon privileges granted by the State to the corporation. (p. 12)

Both the Trial Court and the Tax Court regarded the tax as deductible under Section 23 of the Revenue Act. (p. 13)

The Wisconsin decisions relied upon by the Circuit Court of Appeals determined only the question of State law and not the instant controversy. (p. 15)

The rule announced by the Wisconsin Court concerning deductibility does not appear to be consonant with the federal rule. (p. 17)

## II.

The Privilege Dividend Tax, as a payment exacted from the corporation based upon the privileges extended and protection given by the state to the corporate enterprise, and measured by the exercise of a function necessary to corporate existence, is deductible if it otherwise meets the requirements of Section 23 of the Revenue Act of 1934.

The payment of the dividend tax by a corporation is made under the compulsion of the Statute and arises as an incident to the exercise of a vital corporate function. (p. 25)

## III.

Subsequent decisions of the Wisconsin Supreme Court have not changed the status of the Privilege Dividend Tax as it existed at the time of the trial court's decision.

The Wisconsin Court by subsequent decisions has merely determined, for state purposes, that the economic burden of the tax is passed on to shareholders. (p. 28)

## IV.

Regulations as between corporation and shareholder imposed by the state of Wisconsin in the exercise of its power over corporations domiciled in the state or foreign corporations licensed therein have no more effect on the status of the tax payment under federal law than a contractual arrangement for the sharing of the tax burden.

The economic burden of all corporate taxes would seem to fall upon the shareholder, and hence a state regulation between the corporation and shareholder which asserts the final incidence of a tax is immaterial to the present controversy. (p. 32)

## V.

If notwithstanding the decisions of the Wisconsin Supreme Court and the Federal Supreme Court holding the Privilege Dividend Tax to be incident to corporate privileges and protection extended by the state, it is held that the tax is imposed upon the shareholder, it is still deductible under Section 23 (d) of the Revenue Act of 1934.

If the tax is one imposed upon a shareholder, it appears to be imposed upon his interest as shareholder. (p. 35)

If the tax is one imposed upon a shareholder, it would seem that the other necessary elements for deductibility under Section 23 (d) are present. (p. 36)

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## Argument.

### I.

**The Wisconsin Privilege Dividend Tax is payable by the corporation and is collectible from it only. The usual incidents of tax liability arising from it devolve upon the corporation. The ultimate economic burden of the tax is not important under Section 23 of the Revenue Act of 1934.**

This Court has had previous occasion to consider the Wisconsin privilege dividend tax (Laws of Wisconsin (1935), c. 505, Section 3, as amended by the Laws of Wisconsin (1935), c. 552, Section 1); see Appendix, *infra* p. 39 for provisions of the Act. The Federal question concerning the constitutional power of the State of Wisconsin to impose such a tax was before this Court in *Wisconsin vs. J. C. Penney Co.*, 311 U. S. 435. A judgment of the Wisconsin Supreme Court was reversed on such Federal question.

The petitioner claims the right to deduct under Section 23 of the Revenue Act of 1934 (Appendix, *infra* p. 41) the amount of such tax paid in 1935.

The privilege dividend statute effective in the year 1935 provides:

"For the *privilege* of declaring and receiving dividends out of income derived from property located and business transacted in this state there is hereby imposed a tax \* \* \*." (Italics supplied)

When a dividend is lawfully declared it becomes a debt. While the statute refers to the "privilege of declaring and receiving dividends", the privilege of receiving is purely derivative and involves no legislative indulgence to the shareholder.<sup>1</sup>

<sup>1</sup> See paragraph 3 of footnote page 10, *infra*.

By Subsection (2) every corporation is required to deduct the tax, make returns thereof and *pay* the tax to the Tax Commission.

By Subsection (3) it is provided:

"Every such corporation hereby made liable for the tax shall deduct the amount of such tax from the dividend so declared."

Provision is made in Subsection (4) for the apportionment of the tax in respect of corporations doing business within and without the state so that the privilege dividend tax shall relate only to dividends paid out of corporate surplus and undivided profits derived from business transacted and property located within the state.

By Subsection (5) dividends paid by a subsidiary to a parent corporation are not subject to the tax.

By Subsection (6) the tax is not applicable to dividends declared and paid by Wisconsin corporations out of income reported for taxation to the state if the business of the corporation consists in the receipt and distribution of dividends.

By Subsection (7) the privilege dividend tax is not applicable to stock dividends or liquidating dividends.

Subsection (8) provides that the tax if not paid within the time provided shall become delinquent and the delinquent shall be subject to penalty.

No provision is made in the Act for payment by the shareholder or enforcement of collection from the shareholder. The tax, unlike that involved in *Eastern Gas & Fuel Association vs. Commissioner*, 128 Fed. (2d) 369 (C. C. A. 1st) is not a general tax upon income of shareholders in common with the recipients of income from other sources.

In *Froedtert Grain & Malting Co. vs. Tax Commission*, 221 Wis. 225, the court said at page 245:

"Liability for payment of the tax is imposed upon the corporation."

In the same case at page 237 the court, referring to *Travis vs. Yale & Towne Mfg. Co.*, 252 U. S. 60, said:

"Upon like reason the instant tax may be considered as in effect imposed against the corporation."

The uniform administrative practice is to treat the corporation as the taxpayer and as the sole person liable for payment of the tax.<sup>1</sup>

<sup>1</sup> By order of the Wisconsin Tax Commission, corporations were advised March 4, 1938, that "Wisconsin privilege dividend taxes levied pursuant to Sec. 3, Ch. 505, Laws of 1935, as amended, whether deducted from dividends paid to stockholders or assumed by corporation without deduction from dividends paid to stockholders, are to be computed at a rate of 2 1/2%." (Prentice-Hall, State and Local Tax Service—Wisconsin, Section 13,288.)

In *Household Finance Corp. vs. Department of Taxation*, the Wisconsin Board of Tax Appeals determined a stockholder may not petition for abatement of privilege dividend tax paid by a corporation as the corporation is the aggrieved taxpayer, not the stockholder. (Prentice-Hall, State and Local Tax Service, Wisconsin, Section 13,616.)

In a letter from the Wisconsin Tax Commission by T. Carroll Sizer, attorney, dated April 21, 1936, it is stated that the privilege dividend tax is defined to be an excise tax levied in respect of the declaration and payment of dividends rather than a tax on the receipt of income. (Prentice-Hall, State and Local Service, Wisconsin, Section 13,207.)

*Comet Co. vs. Dept. of Taxation*, 243 Wis. 117, where the court said:

"As in the absence of that provision [an amendment] Comet, as a Wisconsin corporation, would be liable for the privilege dividend tax of two and one-half per cent imposed by the act upon all dividends distributed by it to its stockholders \* \* \*." (Page 123) (Emphasis supplied)

In *J. C. Penney Co. vs. Tax Commission*, 233 Wis. 286, the court declared at page 292:

" \* \* \* It is agreed on all sides that the tax in question is an excise tax and this court so held in the *Froedtert* case. The Court in effect held that the tax was an excise tax—

'for the privilege of declaring and receiving dividends out of income derived from property located and business transacted in this state,'—

and was therefore subject to the jurisdiction of the state as are incomes and inheritances. It is apparent that upon this basis the tax imposed by sub. (1) of sec. 3 of the act, cannot be imposed upon dividends declared by a foreign corporation because they are not declared within this state nor is the privilege one granted by this state."

In the *Penney* case, the Wisconsin Court under the supposed compulsion of the decision of this Court in *Connecticut Gen. L. Ins. Co. vs. Johnson*, 303 U. S. 77, held the tax invalid as to dividends declared outside the State by a foreign corporation. The State obtained review by this Court and upon such review, *Wisconsin vs. J. C. Penney Co.*, 311 U. S. 435, this Court reversed by 5 to 4 decision. In the majority opinion (page 444), it was said:

" \* \* \* The simple but controlling question is whether the state has given anything for which it can ask return. The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax, and the state has not given the less merely because it has conditioned the demand of the exaction upon happenings outside its own borders. The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction."

The minority opinion (page 449) asserted that as the burden of the tax was on the shareholders and Wisconsin



is powerless to tax the incomes of non-resident shareholders, the Statute applied to dividends of foreign corporations declared outside of the state and paid to non-resident shareholders should be condemned.

On remand the Wisconsin Supreme Court (*J. C. Penney Co. vs. Tax Commission*, 238 Wis. 69) quoted the above designated language of the majority opinion of this Court as the basis of its own decision. The Wisconsin Court gave further confirmation to the theory that the validity of the tax rests upon the grant of the privilege of carrying on business in the corporate form within the State of Wisconsin by its decision in *International Harvester Co. vs. Department of Taxation*, 243 Wis. 198-205, where the Court said:

“ . . . If the term ‘jurisdictional fact’ must hereafter be relegated to the limbo of outmoded terms, *the basis of Wisconsin’s power to tax is the fact that it has given its protection and the benefits of government to corporate activities in Wisconsin and that profits from these activities are traceable to the fund from which dividends are paid. So far as the constitutional aspects of the cases are concerned, the federal supreme court has reduced the privilege features of the tax to mere conditions or contingencies, upon the happening of which the tax accrues.*” (Page 205) (Italics supplied)

The court says further on page 206:

“ . . . We adhere to our determination upon remand of the Penney case, *supra*, that this is a privilege tax and that we are bound to accept the mandate of the United States supreme court that its constitutional justification from the standpoint of Wisconsin’s power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend.” (Italics supplied)

“ . . . Sec. 3 of sec. 71.60, Stats., provides without qualification that the tax shall be levied for the privilege of declaring and receiving dividends out

of income derived from property located and business transacted in this state." (page 206)

In the present case, the opinion of the Circuit Court of Appeals in reversal of the Trial Court recognizes that reliance had been placed by the Trial Court upon the decision of this Court in the *Penney* case. Declining to follow that decision because it was thought by the Circuit Court of Appeals to be distinguishable on the facts from the instant case, the close parallel was, nevertheless, noted by the Court below in the following language:

"The reasoning of that case would seem to sustain the District Court's position. Power to tax was the only question before the Court in the *Penney* case (R. 23)."

It is submitted that the language of the majority opinion of this Court in the case of *Wisconsin vs. J. C. Penney Co.*, 311 U. S. 435, in its affirmative determination of the power of the State to tax, justified the District Court in regarding the Wisconsin Privilege Dividend Tax as one " . . . held . . . to be on the corporation and not upon the shareholders". (R. 8)

The Tax Court of the United States in a case decided September 16, 1943, also placed similar reliance upon language used in the majority opinion of this Court in the *Penney* case.

This was the case of *The Montreal Mining Co. vs. Commissioner of Internal Revenue*, 2 T. C. No. 85, Docket No. 106876, in which that court determined that amounts paid as Wisconsin Privilege Dividend Tax were deductible as taxes paid under Section 23 (c) of the Revenue Acts of 1934 and 1936. It was there said:

"The Supreme Court in *Wisconsin, et al, vs. J. C. Penney Co.*, 311 U. S. 435, considered the Wisconsin Privilege Dividend Tax in connection with a consti-



tutional question. In discussing the statute imposing such tax the Court said:

“ \* \* \* The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out.”

Thus, it is apparent that the tax in question was there determined to be a levy on corporate income. Upon the authority of this decision, we hold in petitioner's favor on this issue. The tax is deductible under Section 23 (c) of the Revenue Acts of 1934 and 1936.”

That special importance should be attached to decisions of the Tax Court was recognized by this Court in the case of *Dobson vs. Commissioner of Internal Revenue*, ..... U. S. ...., 88 Law. Ed. Advance Opinions, 179. High tribute was paid in such opinion to the qualifications and attributes of the Tax Court concerning its ability, methods, and presumptive likelihood of rendering fair and accurate decisions. Concerning the rendition of such decisions involving questions of law, the following was there said (page 187) concerning the Tax Court:

“In deciding law questions courts may properly attach weight to the decision of points of law by an administrative body having special competence to deal with the subject matter. The Tax Court is informed by experience and kept current with tax evolution and needs by the volume and variety of its work. While its decisions may not be binding precedents for courts dealing with similar problems, uniform administration would be promoted by conforming to them where possible.”

The Circuit Court of Appeals opinion in the instant case held against the deductibility of the Wisconsin Privilege Dividend Tax under Section 23 (c) of the Revenue Act of 1934 on the assumption that the Petitioner did not bear the economic burden of the tax, which factor it concluded was determinative of the issue. In the opinion reliance was placed upon two decisions of the Wisconsin Supreme Court, *Wisconsin Gas & Electric Company vs. Wisconsin Tax Department*, 243 Wis. 216, and *Blid vs. Wisconsin Foundry and Machine Co.*, 243 Wis. 221. In the latter case, decided upon a demurrer to the complaint, it was determined that a preferred stockholder could not recover from the corporation the amount it had withheld and paid to the state as privilege dividend tax for a dividend declared and paid. In the former case, the Wisconsin Supreme Court had for determination the question of the construction of the Wisconsin Income Tax Statute to determine whether or not the Privilege Dividend Tax was deductible thereunder.

Unlike Section 23 of the Revenue Act which authorizes the deduction of taxes paid with certain enumerated exceptions, the Wisconsin Statute authorizes only the deduction of enumerated taxes. Section 71.03 (4) of the Wisconsin Statutes,<sup>1</sup> in the authorization of the deduction of only specified taxes, includes "taxes paid during the year upon the business or property from which the income taxed is derived." The Wisconsin decisions relied upon by the Circuit Court of Appeals do not purport to decide the controlling Federal question.

<sup>1</sup> "71.03 Deductions from gross income of corporations. Every corporation, joint stock company or association shall be allowed to make from its gross income the following deductions:

(Continued on next page)

Nothing said by the Wisconsin Court in either of the last above mentioned decisions purports to alter its prior pronouncement, in conformity with the determination of this Court, that the tax is reciprocal to and grounded upon corporate privileges extended by the state. In *Wisconsin Gas & Electric Company vs. Department of Taxation*, 243 Wis. 216 on page 220, the Court said:

"So far as Wisconsin's power to reach beyond its borders and to levy the tax is concerned, the United States Supreme Court has declared that Wisconsin has the right to exact the tax because of *protection given to corporate activities in this state* resulting in earnings traceable to the dividends declared and benefits to the stockholder who has received a dividend." (Italics supplied)

In its decision in *Blued vs. Wisconsin Foundry and Machinery Co.*, 243 Wis. 221, at 222, the Wisconsin Court recognizes that the corporation alone is made liable for the tax; that the corporation alone is made liable for the penalty and interest on failure to pay the tax, and that no personal liability is imposed upon the stockholder.

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(4) Taxes other than special improvement taxes paid during the year upon the business or property from which the income taxed is derived, including therein taxes imposed by the state of Wisconsin and the government of the United States as income, excess or war profits and capital stock taxes, including taxes on real property which is owned and held for business purposes whether income producing or not, provided that such portion of the deduction for federal income and excess profits taxes as may be allowable shall be confined to cash payments made within the year covered by the income tax return, and provided further that deductions for income taxes paid to the United States government shall be limited to taxes paid on net income which is taxable under this chapter; and provided further that income taxes imposed by the state of Wisconsin shall accrue for the purpose of this subsection only in the year in which such taxes are assessed." (Wis. Statutes, 1935)

The determination in the case of *Wisconsin Gas & Electric Company vs. Department of Taxation*, 243 Wis. 216, was confined to the proposition that the state dividend privilege tax was not among the enumerated taxes of Section 71.03 (4) upon the payment of which a corporation was entitled to an equivalent deduction from gross income in the computation of net income for state income tax purposes. The Court said (page 219):

“The real question in this case is: On whom is the actual burden of this tax laid? This question can have but one answer. The statute specifically puts it upon the stockholder.”

The decision by this Court of the Federal question in support of the power of the state to impose the Wisconsin Privilege Dividend Tax was adopted by the Wisconsin Supreme Court with appropriate compliance and without any effort to impinge upon the declared principle. The State Court was still at liberty to determine the non-Federal question, in construing the Wisconsin State Income Tax Act, that taxes though based upon the grant of corporate privileges and for which the corporation alone is made liable were not deductible under the income tax law of the state because the ultimate economic burden was borne by the shareholder. The determination of the Wisconsin Court made no pretense of rendering a disposition of any Federal question. To import the reasoning of the Wisconsin Court into the present problem would seem to be introducing concepts of the Wisconsin system of taxation into the, otherwise, self-executing Federal Revenue structure.

The rule announced by the Wisconsin Court is not the rule in respect of taxes deductible by a corporate taxpayer under Section 23 of the Revenue Act.

Though there exist revenue provisions which require, for the purpose of certain refunds, that the taxpayer estab-

lish that he bore the economic burden of the tax as a condition of recovery (Title VII of the Revenue Act of 1936, relating to amounts collected under the Agricultural Adjustment Act), a long line of decisions establish that deduction may be made under Section 23 if the taxpayer is made liable for and pays the tax even though the economic burden may be passed on.

Prior to the time that the statute prescribed the person who might deduct estate and inheritance taxes and before the deduction of such taxes was prohibited, the United States Supreme Court held that the federal estate tax was deductible from the income of the estate as reported in the return of the executor or administrator. This notwithstanding that the ultimate burden of the tax fell upon the beneficiaries of the estate. *United States vs. Woodward*, 256 U. S. 632. Likewise, it was held that a state transfer tax imposed upon the transfer of property from a decedent and paid as required by law by the personal representative was properly deductible in the federal income tax return for the estate. In *Keith vs. Johnson*, 271 U. S. 1, the court said at page 5:

"The law plainly makes it their (the personal representatives') duty to pay the tax out of the estate. The property remaining passes to the beneficiaries. When property is transferred without the deduction of the tax the beneficiary is required to pay. But, by whomever the amount may be handed over to the state, the tax is in effect an appropriation by the state of a part of the property of the deceased at the time of death. And the state's portion is deductible from the legacy and does not pass to the legatee."

. . . . .

"While this lessens the amount for distribution among the heirs, it cannot be said that they bore any part of that tax. As well might it be claimed that they paid the funeral expenses and debts, if any, of



the intestate. No part of the transfer tax so paid could be taken by the heirs as a deduction in calculating their federal income taxes. It follows that the amount of the transfer tax paid in 1917 by the respondent was deductible in ascertaining the taxable income of the estate received by her in that year." (Page 9)

To the same effect is *United States vs. Mitchell*, 271 U. S. 9.

The opinion of the Circuit Court of Appeals, predicated upon the determination of the Wisconsin Court, for purposes solely associated with the state tax structure, of the question of the economic burden of the tax as distinguished from legal liability for the tax, seems to be at variance with the decision of this Court in *Biddle vs. Commissioner of Internal Revenue*, 302 U. S. 573. In that case, American stockholders of a British corporation in reporting United States income taxes sought the right to deduct taxes paid to the British Government in respect of dividends declared. The Circuit Court of Appeals (C. C. A. 2nd) in holding that the deduction could be taken only by the party liable for the payment of the tax without regard to its ultimate burden said:

"(A) Our system of credits and deductions is built around a concept of direct liability for taxation and direct payment. It is not administered upon the theory of ultimate burden or the final incidence of taxation. *Shearer vs. Com'r*, 48 F. (2d) 552, 555 (C. C. A. 2). In the *Shearer* case, the question was whether the purchaser of a car could deduct an excise tax which he had paid to the dealer as an item separate from the purchase price. The court, in holding that the statutory liability for the tax was upon the dealer and that therefore the deduction was properly disallowed, stated: 'If the final incidence of the burden be traced, no doubt the only income, properly speaking, which has borne the tax is the customer's, for it is a fiction to treat as income a sum received by the dealer, which, except for

the tax, would never have come to him at all. \* \* \* But the final incidence of taxation is not a measure of the person on whom the tax is levied, and it seems to us that the form of the statute must control.'

"In other words, our system, to describe it more accurately, looks to the statutory incidence of the tax—to the party which the taxing authority has made directly responsible.

"It is admitted that under the British law the shareholder is not liable for direct assessment. He owes no direct responsibility to the taxing authority; and the corporation, a completely separate entity, pays the tax, not as the collector of revenue or as agent of the shareholder, but in discharge of a primary and sole obligation imposed upon it by the British acts. True, the shareholder may bear the ultimate burden, depending on whether the corporation declares and pays a dividend out of the profits for which it is taxed and whether, in accordance with rule 20, it elects to deduct the amount of appropriate income tax computed by the prevailing standard rate in the year of payment. Even so, he is not a taxpayer; he does not bear the statutory incidence of the tax."

*Biddle vs. Commissioner*, 86 Fed. (2d) 718 at 720.

In a similar case, *F. W. Woolworth Co. vs. United States*, 91 Fed. (2d) 973 (certiorari denied, 302 U. S. 768), Judge Hand, writing for the Second Circuit Court of Appeals, said:

" \* \* \* We might agree that if the plaintiff could point to a legal duty laid upon shareholders which was discharged, section 238 (a) would protect it, but it cannot do so. At most it can say that the shareholders may in some circumstances be sureties for a tax primarily imposed upon the corporate personality, but that would not make them 'pay' the tax any more than any other surety pays when the principal pays. It does not advance the solution to say as in *United Shoe Machinery Co. vs. White*, 89 F. (2d) 363 (C. C. A. 1), that it makes no difference to the shareholder whether he pays the tax, or whether the corporation pays it and takes it out of his divi-

dend. That is true, but the final incidence of the tax does not determine its legal nature; else the shareholders would pay the normal corporate tax under our own system. We adhere to our decision in *Biddle vs. Commissioner*, supra, 86 F. (2d) 718." (Page 975)

On *certiorari* the United States Supreme Court said in *Biddle vs. Commissioner of Internal Revenue*, 302 U. S. 573:

"One of the companies availed itself of the statutory permission to declare a gross dividend, from which it deducted the tax before actual distribution, certifying to the taxpayers that the dividend would be paid 'less' income tax. The other two companies declared the dividend in the amount distributed to stockholders and certified that it was 'free of tax.' The certificates of the latter did not purport to show any deduction of tax from a gross dividend, but did indicate the amount of the tax appropriate to the dividend and showed the same net return to stockholders as if the tax had been deducted from a computed gross dividend." (Page 576)

. . . . .

"Section 131 does not say that the meaning of its words is to be determined by foreign taxing statutes and decisions, and there is nothing in its language to suggest that in allowing the credit for foreign tax payments, a shifting standard was adopted by reference to foreign characterizations and classifications of tax legislation. The phrase 'income taxes paid' as used in our own revenue laws, has for most practical purposes a well understood meaning to be derived from an examination of the statutes which provide for the laying and collection of income taxes. It is that meaning which must be attributed to it as used in Section 131.

"Hence the board's finding, supported as it is by much expert testimony, that 'the stockholder receiving the dividend is regarded in the English income tax acts as having paid "by deduction or other-



wise" the tax "appropriate" to the dividend" is not conclusive. At most it is but a factor to be considered in deciding whether the stockholder pays the tax within the meaning of our own statute. That must ultimately be determined by ascertaining from an examination of the manner in which the British tax is laid and collected what the stockholder has done in conformity to British law and whether it is the substantial equivalent of payment of the tax as those terms are used in our own statute." (Page 578)

• • • • •

"• • • The corporation pays the standard tax and against it the remedies for non-payment run." (Page 579)

• • • • •

"Although the corporation, in the United Kingdom as here, pays the tax and is bound to pay it, the tax burden in point of substance is passed on to the stockholders in the same way that it is passed on under our own taxing acts where the tax on the corporate income is charged as an expense before any part of the resulting net profit is distributed to stockholders. See Magill, Taxable Income, 24 et seq. Whether the tax is deducted from gross profits before a dividend is declared, or after, when the deduction is taken from the gross dividend, the net amount received by the stockholder is the same. Under either system, if no dividend is declared no tax is paid by the stockholder. If a dividend is declared it must be paid, however the deduction is made, from what is left after the corporation has paid taxes upon its earnings." (Page 580)

• • • • •

"Inclusion of the deducted amount in the base on which surtax is calculated, together with the provisions for refund of the tax to the stockholder who, in any event, bears its economic burden, are logical recognitions of the British conception that the stand-

ard tax paid by the corporation is passed on to the stockholders.

"Our revenue laws give no recognition to that conception. Although the tax burden of the corporation is passed on to its stockholders with substantially the same results to them as under the British system, our statutes take no account of that fact in establishing the rights and obligations of taxpayers. Until recently they have not laid a tax, except surtax, on dividends, but they have never treated the stockholder for any purpose as paying the tax collected from the corporation. Nor have they treated as taxpayers those upon whom no legal duty to pay the tax is laid. Measured by these standards our statutes afford no scope for saying that the stockholder of a British corporation pays the tax which is laid upon and collected from the corporation, and no basis for a decision that Section 131 extends to such a stockholder a credit for a tax paid by the corporation — a privilege not granted to stockholders in our own corporations. It can hardly be said that a tax paid to the Crown by a British corporation subject to United States income tax is not a tax paid within the meaning of Section 23 (c) (2) of the 1928 Act, which allows a deduction from gross income for taxes paid to a foreign country, cf. *Welch vs. St. Helens Petroleum Co.* (C. C. A. 9th), 78 F. (2d) 631, or that its stockholders could take credit under Section 131 for their share of the tax on the theory that they also had paid it." (Page 581)

In the *Biddle* case the tax which was paid by the corporation under the law of its domicile and for which it was made liable and the deduction of which could not be denied the corporation within the meaning of Section 23 (c) (2) of the 1928 Act was, nevertheless, a tax upon the income received by the shareholder. *A fortiori* a privilege dividend tax for which the corporation is made liable and which is collectible from it *only* but the validity of which rests upon

corporate privileges granted the corporation should be held deductible.

The most that can be claimed by respondent is that the State of Wisconsin in construing its own tax laws takes the British view that the deduction can be claimed only by one bearing the ultimate economic burden of the tax.

The question involved in this case is purely a federal question though it involves consideration of a tax for which the corporation is made liable by the Wisconsin Statutes. The Act is the same as that considered by this Court in *Wisconsin vs. J. C. Penney Co.*, 311 U. S. 435. The Wisconsin Court has not by any feat of construction changed or attempted to change the plain meaning of the law. Liability for the privilege tax in the present case is imposed *solely* upon the corporation with no effort made by the Wisconsin Statute to impose either a contingent or secondary liability upon the shareholder. From the standpoint of legal liability, the shareholder enters the picture only by reason of the fact that the dividends received by him bear an arithmetical relationship to the tax liability of the corporation. The instant decision of the Circuit Court of Appeals seems to have departed from the rule of law announced in the *Biddle* case.

## II.

**The Privilege Dividend Tax as a payment exacted from the corporation based upon the privileges extended and protection given by the state to the corporate enterprise, and measured by the exercise of a function necessary to corporate existence, is deductible if it otherwise meets the requirements of Section 23 of the Revenue Act of 1934.**

Admittedly the payment by a mere volunteer of the tax liability of another does not entitle the volunteer to the deduction. Nor may one qualify for the deduction by accept-

ing and discharging a private contractual liability to pay the tax or to reimburse one liable therefore.<sup>1</sup>

Personal liability for payment of the tax must be placed upon the person seeking the benefit of the deduction authorized. The Wisconsin Privilege Dividend Tax is sustained by both the state court and this Court as resting upon the grant by the state of corporate privileges and protection to the corporate enterprise. It is most appropriate that personal liability for payment of the tax be placed on the corporation. The imposition and measurement of the tax are related to the exercise by the corporation of a vital corporate function which conditions its very existence.

The "economic obligation" to pay dividends on stock<sup>2</sup> is essential to the survival of a corporation in the competitive effort to secure and share capital.

The payment of dividends is also necessary if profits are available therefore to avoid penalties under the Revenue Act for the unreasonable accumulation of profits.

A business privilege tax is deductible in a taxpayer's federal income tax return. (I. T. 3191, C. B. 1938-1, page 143.)

The Motor Vehicle Excise Tax under Section 900 of the Act of 1921 is deductible by the seller who is liable therefor though the burden falls upon the buyer. In respect of this tax in *Shearer vs. Commissioner*, 48 Fed. (2d) 552 (C. C. A. 2nd), the court said on page 555:

<sup>1</sup> *Magruder vs. Supplee*, 316 U. S. 394; *Falk Corp. vs. Commissioner*, 60 Fed. (2d) 204 (C. C. A. 7th); *Eastern Gas. & Fuel Association vs. Commissioner*, 128 Fed. (2d) 369 (C. C. A. 1st).

<sup>2</sup> See dissenting opinion of Mr. Justice Brandeis in *Missouri ex rel. S. W. Bell Tel. Co. vs. Public Service Commission*, 262 U. S. 276 at page 306.

"But the final incidence of taxation is not a measure of the person on whom the tax is levied, and it seems to us that the form of the statute must control."

Federal excise taxes on gasoline are deductible by the manufacturer, producer or importer. I. T. 3378, C. B. 1940-1, page 36, where it is said:

"The manufacturers' excise tax on gasoline imposed by section 3412 of the Internal Revenue Code is clearly imposed upon the manufacturer, producer, or importer, and is, therefore, deductible by him for Federal income tax purposes. (See Minn. 3988, C. B. XI-2 25 (1932).) The tax is not deductible from gross income in the return of the consumer even though the amount thereof is passed on to him."

Formal corporate action in the declaration of a dividend is a pre-requisite to liability for the tax. *Northwest Engineering Corp. vs. Department of Taxation*, 241 Wis. 324.<sup>1</sup>

True, the dissenting opinion on behalf of four members of the Court written by Justice Roberts in *Wisconsin vs. J. C. Penney Co.*, 311 U. S. 435 at page 448, quoted in the opinion of trial court (R. 8) voices, as stated by the trial court, the contentions of the Government, which, if sound, invalidate the privilege dividend tax law as indicated by such dissenting opinion, but such contentions are not the law as pronounced by this Court or by the state court. Indeed, the state court whose decision voiding the Act as to dividends of foreign corporations declared outside of the state (*J. C. Penney Co. vs. Tax Commission*, 233 Wis.

<sup>1</sup> On page 327 the court said:

"The term 'dividend' has a well-settled meaning, and it does not extend to commercial benefits to a stockholder who buys the company's product at a discount for the purpose of dealing in that merchandise."

286) was reversed, did not use the reasoning of the dissenting opinion, but at the suit of the corporation held on the supposed authority of *Connecticut Gen. L. Ins. Co. vs. Johnson*, 303 U. S. 77, that the foreign activities of the corporation were not taxable by the state. Justice Fowler dissented. In substance his views as expressed in the dissenting opinion were vindicated by the majority decision of the Federal Supreme Court and on remand were adopted by the state court. *J. C. Penney Co. vs. Tax Commission*, 238 Wis. 69.

This Court in distinguishing the *Connecticut Gen. L. Ins. Co.* case used the following significant language:

"In the precise circumstances presented by the record it was found that the tax neither in its measure nor in its incidence was related to California transactions. Here, on the contrary, the incidence of the tax as well as its measure is tied to the earnings which the State of Wisconsin has made possible, insofar as government is the pre-requisite for the fruits of civilization for which, as Mr. Justice Holmes was fond of saying, we pay taxes." (page 446)

*State of Wisconsin vs. J. C. Penney Co.*, 311 U. S. 435.

### III.

**Subsequent decisions of the Wisconsin Supreme Court have not changed the status of the Privilege Dividend Tax as it existed at the time of the trial court's decision.**

True, a state court may by interpretation substantially amend or change a state statute and the statute is to be taken as so construed, but the Wisconsin Court has not by interpretation changed the plain meaning of the statute. Upon remand, the Wisconsin Court gave full exposition to the views of this Court as to the basic nature of the tax.



To adopt the views of the dissenting opinion filed in this Court would assuredly invalidate the statute.

At the time of the filing of the opinion of the trial court on September 25, 1942, the trial court had before it the decision of the state court on remand, which was rendered May 20, 1941 (*J. C. Penney Co. vs. Tax Commission*, 238 Wis. 69). The opinion of the trial court appears to be clearly sound and its validity is not disturbed by the decisions of the Wisconsin Supreme Court of June 16, 1943, in *International Harvester Co. vs. Wisconsin Department of Taxation*, 243 Wis. 198, *Wisconsin Gas & Electric Company vs. Wisconsin Department of Taxation*, 243 Wis. 216, and in *Blued vs. Wisconsin Foundry & Machine Company*, 243 Wis. 221. These decisions adhere to the decision on remand in *J. C. Penney Co. vs. Tax Commission*, 238 Wis. 69. They do not have the effect of adopting the dissenting opinion filed in this Court or introduce any new fact except the circumstance, not pertinent here, that the privilege dividend tax is not deductible for state income tax purposes by the corporate taxpayers personally liable therefor because the economic burden of the tax is passed on. There is not the slightest reason for assuming that the state court has adopted a construction of the Act which results in its invalidity. The decision of that court was directed to the question before it, namely, whether the tax paid on dividends was within the specified items of the deductibility provision of the Wisconsin income tax statute (71.03 (4)) and more specifically whether the tax was "paid during the year upon the business or property from which the income taxed is derived."

While this Court has frequently indicated the general considerations prompting it to give weight to the interpretations placed upon a state statute by the court of that state, such principle will not govern in the adjudication of fed-

eral rights. In the case of *State of New Jersey vs. Anderson*, 203 U. S. 483, at page 491, it was said:

"While we take this view of the decisions of the supreme court of New Jersey, and reach the conclusion that the claim in question is for a tax within the meaning of the law as construed by that court, the bankruptcy act is a Federal statute, the ultimate interpretation of which is in the Federal courts.

• • • • •

Conceding the doctrine that the meaning of a statute is a state question, except where rights, the subject of adjudication by the Federal courts, have accrued before its construction by the state court, or the question of contract within the protection of the Federal Constitution is involved, still a state court, while entitled to great consideration, cannot conclusively decide that to be a tax within the meaning of a Federal law providing for the payment of taxes, which is not so in fact."

Such limitation was also recognized in the case of *Carpenter vs. Shaw*, 280 U. S. 363, at page 367, where the opinion, by Justice Stone, contains this language:

"Where a Federal right is concerned we are not bound by the characterization given to a state tax by state courts or legislatures, or relieved by it from the duty of considering the real nature of the tax and its effect upon the Federal right asserted."

It is, of course, a familiar rule that the characterization or name assigned by a state court to a particular state fiscal statute is not binding upon this court. *New York, Philadelphia, & Norfolk Telegraph Co. vs. Dolan*, 265 U. S. 96, at page 98; *Stewart Dry Goods Co. vs. Lewis*, 294 U. S. 550, at page 555. In *Schuylkill Trust Co. vs. Pennsylvania*, 296 U. S. 113, at page 119, it was said in the opinion rendered by Justice Roberts:

"We give great weight to the characterization of a tax, or the interpretation of a state law, emanating

from the highest court of the state, but where a federal question is involved we are not bound by the label attached to the tax or the character ascribed to the law. We must determine for ourselves the true nature of the tax by ascertaining its operation and effect."

In the brief filed below on behalf of the Government, reliance was therein placed upon the case of *National Bank of Commerce vs. Allen*, 223 Fed. 472 (C. C. A. 8th). It is submitted that there is nothing in such case which aids the Government's position. There the State Personal Property Tax was specifically exerted against the shares of stock held by the stockholders of the bank. The State was without power to tax the bank as such. The statute was construed so as to sustain its validity and was held to be a tax upon the shareholders and not upon the bank. The property taxed did not belong to the bank but to the shareholders.

The case of *Central Bank vs. United States*, 137 U. S. 355, also cited by the Government in its brief below, seems to be clearly lacking in pertinency. The tax there was not upon a corporate privilege and did not involve the passing on of the economic burden of the tax. The court declared (page 363):

"The tax is constituted a claim against the stockholders only and the bank was made simply an agent to collect them for the state."

## IV.

**Regulations as between corporation and shareholder imposed by the State of Wisconsin in the exercise of its power over corporations domiciled in the state or foreign corporations licensed therein have no more effect on the status of the tax payment under federal law than a contractual arrangement for the sharing of the tax burden.**

The State of Wisconsin under its reserved power in respect of the corporate charters (Section 1 of Article XI of the Wisconsin Constitution) may regulate the internal affairs of Wisconsin corporations. All shareholders hold their stock subject to the exercise of such legislative power. *Vieux vs. Sixth Ward Building & Loan Association*, 310 U. S. 32; *Schuylkill Trust Co. vs. Pennsylvania*, 302 U. S. 506, 514; see also *State Tax Comm. of Utah vs. Aldrich*, 316 U. S. 174-181. In the case of *Rogers vs. Guaranty Trust Co.*, 288 U. S. 123, such view was expressed at Page 130 in the following language:

“When, by acquisition of his stock, plaintiff became a member of the corporation he, like every other shareholder, impliedly agreed that in respect of its internal affairs the company was to be governed by the laws of the State in which it was organized.”

In respect of foreign corporations, the state generally has a broad power to compel their submission to regulations imposed upon corporations of the domicile.

Provisions of the privilege dividend tax law, which pass on the economic burden of the tax considered as in effect an amendment of the corporate charter, became contractual as between the corporation and the shareholder just as the trust indenture of the corporation in *Eastern Gas & Fuel Association vs. Commissioner*, 128 Fed. (2d) 369 (C. C. A. 1st) assumed contractually to pay the state income taxes of shareholders where the corporation creating the trust

indenture was under no obligation to pay such taxes. However, the analogy of contractual relationship applies only to the factor of the economic burden of the tax since the duty of the corporation to pay the tax is clearly of statutory rather than of contractual origin.

As the economic burden of all corporate taxes falls upon the shareholders, the direction of the Wisconsin Statute that the amount of the tax be deducted from the dividend reaches only a matter of empty form.

If the corporation proposes to distribute one dollar per share to its common stockholders, literal observance of the statute would require that the distribution in form be \$1.00 per share plus the tax, that the tax after being so added be then subtracted and the \$1.00 remitted. If, however, the corporation announces that it will pay the tax and declares a tax-free net dividend of one dollar per share, the result is the same. In each instance the state will receive the same amount of tax, the common stockholder will receive the same amount upon his share holdings, and the corporate cash and undistributed surplus accounts will be exactly the same.

If a corporation were to declare and pay a net common dividend without including the amount of the tax therein but paying the proper tax to the state and announcing its purpose in that respect, it seems clear that no court would recognize that any party was aggrieved by the form of the procedure or attempt, by mandamus or otherwise, to compel the corporation to make the idle gesture contemplated by statute. This is exactly in accord with the order of the Wisconsin Tax Commission promulgated March 4, 1938. (Prentice-Hall, State and Local Tax Service—Wisconsin, Section 13,288.) (Footnote, page 10)

When the corporation pays the tax, corporate assets are depleted by the amount of the payment. There is no true



reimbursement by the shareholder. The depletion is not restored. It is to be noted that the privilege dividend tax is computed on the amount of dividend *paid*, not on the amount of dividend including tax declared. The state legislature in putting the economic burden of the tax on the shareholder has merely recognized the inevitable. The burden could not fall elsewhere.

## V.

**If, notwithstanding the decisions of the Wisconsin Supreme Court and the Federal Supreme Court holding the Privilege Dividend Tax to be incident to corporate privileges and protection extended by the state it is held that the tax is imposed upon the shareholder, it is still deductible under Section 23(d) of the Revenue Act of 1934.**

Petitioner in Section V of its brief filed with the Circuit Court of Appeals asserted, as an alternative contention, that if it should be held that the Wisconsin Privilege Tax was imposed upon the shareholder it is, nevertheless, deductible under Section 23 (d) of the Revenue Act of 1934. The opinion of that Court makes no reference to such assertion. The mandate, however, is one of complete reversal of the judgment of the Trial Court. It would appear that such proposition has never before received the attention of this Court.

Petitioner has heretofore endeavored to point out cogent reasons for regarding the tax involved herein as one imposed upon the corporation. If, however, it is determined that the tax is imposed upon the shareholder, its deductibility is claimed under Section 23 (d) of the Revenue Act of 1934 which admits of deduction "in case of taxes imposed upon a shareholder of a corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder \* \* \*".



In *Eastern Gas & Fuel Association vs. Commissioner*, 128 Fed. (2d) 369 (C. C. A. 1st), it was held that this provision relates only to taxes upon shares of property represented by shares and not to taxes on the income of the shares or receipt of part of the property represented by the shares. In view of the legislative history of the Act, we doubt the soundness of this conclusion. Section 23 (d) was first introduced as a part of the Revenue Act of 1921. The Conference Committee report agreeing to a Senate change states:

"This amendment provides that a tax of the kind generally allowed as a deduction may be taken as a deduction by a corporation if it is a tax imposed upon a shareholder or member upon his interest as such and paid by the corporation without reimbursement from the shareholder, further providing that in such case no deduction shall be allowed the shareholder," (1939-1 C. B. (Part 2) 221)

The expression "interest as a shareholder" would seem to include all of the rights inuring to a person by virtue of his holding stock. The right to dividends is an incident to the ownership of stock. In *re Starbuck's Executrix*, 251 N. Y. 439. The *Restatement of the Law, Conflict of Laws*, in Section 42 (b) defines interest to include "varying aggregates of rights, privileges, powers and immunities and distributively to mean any one of them."

The words "interest in property" have been used for many years in the Federal Estate Tax Law as embracing all types of property rights, including many rights amounting to less than a fee.

One who has the right to the income from property for life clearly has an "interest therein." In the case of a transfer of stock with the income to one for life and remainder to another, it would seem quite clear that both life tenant and remainderman have an interest as a shareholder. The interest of the former is the right to receive the divi-

dends, and a tax upon that right is a tax upon his interest in the corporation within the meaning of Section 23 (d). Thus, a tax upon the right to receive dividends, if paid by the corporation without reimbursement, appears to meet every test of deductibility under subsection (d) of Section 23 of the Revenue Act of 1934.

Payment by petitioner as a corporation is admitted. If the tax is imposed upon a shareholder, it would seem to be "upon his interest as shareholder." Such expression would appear to include all of the rights inuring to a person by virtue of his holding stock including the right to dividends as an incident to the ownership thereof. The word "interest" is one of extremely broad import and it cannot be presumed that Congress intended its use in any narrow or restricted sense.

There has been no reimbursement to the corporation from the shareholder and the theory of the economic incidence of the tax cannot reasonably be indulged in or used as a legal fiction to supply the element of reimbursement. The question of the economic incidence of a tax as between a shareholder and a corporation was discussed in the case of *Biddle vs. Commissioner of Internal Revenue*, 302 U. S. 573, and the following language was used at p. 580:

"Although the corporation, in the United Kingdom as here, pays the tax and is bound to pay it, the tax burden in point of substance is passed on to the stockholders in the same way that it is passed on under our own taxing acts where the tax on the corporate income is charged as an expense before any part of the resulting net profit is distributed to stockholders. See Magill, *Taxable Income*, 24 et seq. Whether the tax is deducted from gross profits before a dividend is declared, or after, when the deduction is taken from the gross dividend, the net amount received by the stockholder is the same. Under either system, if no dividend is declared no tax is paid by the stockholder. If a dividend is declared it must

be paid, however the deduction is made, from what is left after the corporation has paid taxes upon its earnings \* \* \* " (page 580)

Reimbursement clearly connotes action of repayment made after an initial payment. *Webster's New International Dictionary* defines the word reimburse as meaning "to pay back; repay \* \* \* to make restoration or payment of an equivalent to (a person)". The elements of deductibility under subsection (d) of Section 23 of the Revenue Act of 1934 seem to exist and if the tax presently involved is regarded as one imposed upon a shareholder it is, nevertheless, deductible by the corporation.

### CONCLUSION.

This Court found it necessary to deny the correctness of the state court's conclusion in *J. C. Penney Co. vs. Tax Commission*, 233 Wis. 286, that the tax as applied to the dividends of a foreign corporation declared outside of the state is violative of the Federal Constitution because the privilege of declaring such dividends was not granted by the state of Wisconsin. It is not fair to assume that the Wisconsin Court refused to accept either the letter or substance of such determination of this Court, despite any divergence in nomenclature which may still persist between the two jurisdictions. Both Courts are now agreed that the tax rests upon corporate privileges and protection granted by the state of Wisconsin and is collectible on dividends declared by a foreign corporation outside of the state to the extent that income earned in Wisconsin is distributed and that the tax is a charge for the grant of corporate privileges. The obligation to pay such a tax should and does rest primarily on the direct beneficiary of such corporate privileges. The corporation itself is the

direct beneficiary of the state indulgence in return for which the tax is imposed.

A corporation does not occupy the position of a mere collector of a tax nor act either as agent for the state or for the shareholder when only the corporation is personally liable therefor and the tax itself is a charge based upon the enjoyment by it of corporate protection and privileges extended by the state. This is not changed by the legislative direction that as a matter of internal arrangement between the corporation and its shareholders the latter are to bear the ultimate burden of the tax as they inevitably bear the burden of all corporate taxes.

The judgment of the United States Circuit Court of Appeals for the Seventh Circuit should be reversed.

Respectfully submitted,

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February ....., 1944.



## APPENDIX.

### Wisconsin Privilege Dividend Tax.

Laws of Wisconsin (1935), c. 505, Sec. 3, as amended by Laws of Wisconsin (1935), c. 552, Sec. 1.

Section 3. *Privilege dividend tax.* (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to two and one-half per centum of the amount of such dividends declared and paid by all corporations (foreign and local), except those specified in paragraphs (d) and (g) of Section (1) of Section 71.05 of the Statutes, after the passage and publication of this act and prior to July 1, 1937. Such tax shall be deducted and withheld from such dividends payable to residents and non-residents by the payor corporation.

(2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make returns thereof and pay the tax to the tax commission, reporting such tax on the forms to be prescribed by the tax commission.

(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.

(4) In the case of corporations doing business within or without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to



this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall, upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state.

(5) Dividends paid by a subsidiary corporation to its parent shall not be subject to the tax herein imposed provided that the subsidiary and its parent report their income for taxation under the provisions of chapter 71 on a consolidated income return basis, or both corporations report separately.

(6) The provisions of this section shall not apply to dividends declared and paid by a Wisconsin corporation out of its income which it has reported for taxation under the provisions of chapter 71, if the business of such corporation consists in the receipt of dividends and the distribution thereof to its stockholders.

(7) For the purposes of this section dividends shall be defined as in section 71.02, except that the tax herein imposed shall not apply to stock dividend or liquidating dividends.

(8) The tax hereby levied, if not paid within the time herein provided, shall become delinquent and when delinquent shall be subject to a penalty of two per cent on the amount of the tax and interest at the rate of one-half per cent per month until paid.

(9) The tax hereby imposed shall, when collected by the tax commission, be paid by it into the state treasury.

**Extract from the Revenue Act of 1934.**

*"Sec. 23. Deductions from gross income.*

In computing net income there shall be allowed as deductions:

(a) Expenses. . . .

(b) Interest. . . .

(c) Taxes Generally. Taxes paid or accrued within the taxable year, except—

(1) Federal income, war-profits, and excess-profits taxes;

(2) income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States; but this deduction shall be allowed in the case of a taxpayer who does not signify in his return his desire to have to any extent the benefits of section 131 (relating to credit for taxes of foreign countries and possessions of the United States);

(3) estate, inheritance, legacy, succession, and gift taxes; and

(4) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

(d) *Taxes of shareholder paid by corporation.* — The deduction for taxes allowed by subsection (c) shall be allowed to a corporation in the case of taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes."